

The Department's regulation, "Sellers of Machinery, Tools and Special Order Items" at 86 Ill. Adm. Code 130.2115 provides guidance for determining whether a business is subject to Retailers' Occupation Tax or Service Occupation Tax. (This is a GIL.)

September 26, 2006

Dear Xxxxx:

This letter is in response to your letter dated May 26, 2006, in which you request information. The Department issues two types of letter rulings. Private Letter Rulings ("PLRs") are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. Persons seeking PLRs must comply with the procedures for PLRs found in the Department's regulations at 2 Ill. Adm. Code 1200.110. The purpose of a General Information Letter ("GIL") is to direct taxpayers to Department regulations or other sources of information regarding the topic about which they have inquired. A GIL is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120. You may access our website at [www.ILTAX.com](http://www.ILTAX.com) to review regulations, letter rulings and other types of information relevant to your inquiry.

The nature of your inquiry and the information you have provided require that we respond with a GIL. In your letter you have stated and made inquiry as follows:

Our company is engaged in manufacturing computer systems in STATE. As part of the process, we sometimes order component parts from manufacturing vendors in Illinois. These component parts are incorporated into the systems that we manufacture and sell to customers.

In addition to the cost of component parts, our vendors charge us for non recurring engineering charges (NRE) and also the cost of tooling (either built by the same vendor or purchased from a third party) on their invoice. We would like to get confirmation from your Department with respect to the taxability of these charges.

1. Is the NRE fee (service only) subject to tax in your state?
2. Would it make any difference if the NRE fee includes the delivery of prototypes?
3. Is tooling taxable in Illinois?
4. Since both the NRE charges and tooling were used in the manufacturing process, would these charges qualify for manufacturing exemption in Illinois?

Thank you in advance for your prompt response on the matter.

If you have any questions, please call me.

## DEPARTMENT'S RESPONSE

You have not provided enough information for us to provide a specific answer to your questions. However, we hope the following information is helpful.

The Illinois Retailers' Occupation Tax Act imposes a tax upon persons engaged in this State in the business of selling tangible personal property to purchasers for use or consumption. See 86 Ill. Adm. Code 130.101. The Use Tax Act imposes a tax upon the privilege of using in this State tangible personal property purchased at retail from a retailer. See 86 Ill. Adm. Code 150.101.

If no tangible personal property is being transferred to the customers, then no Illinois Retailers' Occupation Tax or Use Tax would apply. Likewise, the Service Occupation Tax Act and Service Use Tax are imposed on the transfer of tangible personal property incident to sales of service. See 86 Ill. Adm. Code 140.101 and 160.101. If no tangible personal property is being transferred to the customers incident to the services provided, then no Illinois Service Occupation Tax nor Service Use Tax would apply.

Based upon the information you have provided, we suggest that you refer to the Department's regulation regarding Sellers of Machinery, Tools and Special Order Items. 86 Ill. Adm. Code 130.2115. This will help you determine whether your business is subject to Retailers' Occupation Tax or Service Occupation Tax. If your business meets the test set out in Subsection 130.2115(b), it will be subject to Service Occupation Tax rather than Retailers' Occupation Tax. A brief summary of the Service Occupation Tax follows.

The purchase of tangible personal property that is transferred to service customers may result in either Service Occupation Tax liability or Use Tax liability for the servicemen, depending upon how the serviceman calculates his or her liability. There are four ways that the tax can be calculated: (1) separately stated selling price; (2) 50% of the entire bill; (3) Service Occupation Tax on the cost price if they are registered de minimis servicemen; or, (4) Use Tax on the cost price if the servicemen are de minimis and are not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act.

Using the first method, servicemen may separately state the selling price of each item transferred as a result of sales of service. The tax is based on the separately stated selling price of the tangible personal property transferred. If servicemen do not wish to separately state the selling price of the tangible personal property transferred, those servicemen must use the second method where they will use 50% of the entire bill to their service customers as the tax base. Both of the above methods provide that in no event may the tax base be less than the cost price of the tangible personal property transferred. Under these methods, servicemen may provide their suppliers with Certificates of Resale when purchasing the tangible personal property to be transferred as a part of the sales of service. Upon selling their product, they are required to collect the corresponding Service Use Tax from their customers. See 86 Ill. Adm. Code 140.106.

The third way servicemen may account for their tax liability only applies to de minimis servicemen who have either chosen to be registered or are required to be registered because they incur Retailers' Occupation Tax liability with respect to a portion of their business. Servicemen may qualify as de minimis if they determine that their annual aggregate cost price of tangible personal property transferred incident to sales of service is less than 35% of their annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphic arts production). See 86 Ill. Adm. Code 140.101(f). This class of registered de minimis servicemen are authorized to pay Service Occupation Tax (which includes local taxes) based upon the cost price of

tangible personal property transferred incident to sales of service. Servicemen that incur Service Occupation Tax collect the Service Use Tax from their customers. They remit the tax to the Department by filing returns and do not pay tax to suppliers. They provide suppliers with Certificates of Resale for the property transferred to service customers. See 86 Ill. Adm. Code 140.108.

The final method of determining tax liability may be used by de minimis servicemen not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act. Servicemen may qualify as de minimis if they determine that their annual aggregate cost price of tangible personal property transferred incident to sales of service is less than 35% of their annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphic arts production). Such de minimis servicemen may pay Use Tax to their suppliers or may self assess and remit Use Tax to the Department when making purchases from unregistered out-of-State suppliers. Those servicemen are not authorized to collect "tax" from their service customers because they, not their customers, incur the tax liability. Those servicemen are also not liable for Service Occupation Tax. It should be noted that servicemen no longer have the option of determining whether they are de minimis using a transaction-by-transaction basis. See 86 Ill. Adm. Code 140.109.

Regarding the manufacturing machinery and equipment exemption, we refer you to the Department's regulation, "Manufacturing Machinery and Equipment," at 86 Ill. Adm. Code 130.330. 86 Ill. Adm. Code 130.330(a) provides that notwithstanding the fact that the sales may be at retail, the Retailers' Occupation Tax does not apply to sales of machinery and equipment used primarily in the manufacturing or assembling of tangible personal property for wholesale or retail sale or lease.

For information regarding sales for resale, we refer you to the Department's regulations at 86 Ill. Adm. Code 130.1401 and 86 Ill. Adm. Code 130.1405.

If you require additional information, please visit our website at [www.ILTAX.com](http://www.ILTAX.com) or contact the Department's Taxpayer Information Division at (217) 782-3336. If you are not under audit and you wish to obtain a binding PLR regarding your factual situation, please submit a request conforming to the requirements of 2 Ill. Adm. Code 1200.110 (b).

Very truly yours,

Martha P. Mote  
Associate Counsel

MPM:msk